

FY 2012 Annual Report

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Dear Director Ryan:

It is a pleasure to be part of Arizona Correctional Industries 25th Anniversary, which is a celebration of the people, passion, character, and strength that has built this company. This opportunity represents more than the chance to look back on historical success but also gives us a chance to reflect on the solid foundation built for our future growth.

Fiscal year 2012 proved to be another strong year for our company, allowing us to surpass last year's sales even in a challenging overall economy. Sales increased 12% to \$38,450,425 with a net income of \$3,184,149 and inmate hours worked increased by over 304,000 with 3,812,848 total inmate hours worked. As we began fiscal year 2012, we faced an unstable state economy that forced ACI to concentrate on managing the aspects of our business that we could control: mainly marketing, operating processes, quality, and our balance sheet.

Marketing became a bigger priority within ACI as witnessed by our improved web site, more focused advertising, innovative new custom products, and a new easy to assemble trade show display. Marketing will continue to be a focus in FY 2013 with the planned hiring of a full-time marketing manager and renewed emphasis on web sales, direct e-mail marketing, and phone campaigns to build brand awareness. We believe these efforts will significantly impact our ability to increase inmate employment.

An expanded concentration on quality during the past fiscal year resulted in several changes in our lean continuous improvement program. A relocation of the program to Florence will allow the new program manager to focus on our Owned and Operated shops as well as critical processes. This will align ACI more closely with lean trends in the private sector and will help facilitate the training of all associates and inmates in lean thinking.

We are fortunate once again to utilize the results of the Arizona State University WP Carey School of Business, Seidman Research Institute study that estimates the economic impact of ACI to the State of Arizona. This year the estimated economic impact was \$187,430,000 and resulted in the creation of 2,080 jobs in the private sector.

As we celebrate our 25th year, mindful of the challenges and responsibilities of this business, we sincerely thank you for your leadership, and our Advisory Board, associates, customers, and suppliers for their dedication, interest, and support throughout the year.

Sincerely,

Brian Radecki

CEO/General Manager

Mission Statement

To create opportunities for offenders to develop marketable skills and good work habits through enterprises that produce quality products and services for our customers while achieving our revenue, profit and inmate work increase objectives.

Core Values

Who We Are:

- We are a unique self-funded business within the Arizona Department of Corrections.
- We are honest, hardworking, and dependable.
- We have the highest Ethical Standards and we always seek to do the right thing.
- We enjoy our work and celebrate our achievements.

What We Do:

- We employ inmates so they can learn and be productive.
- We provide a safe and secure environment for all of our workers.
- We strive to constantly improve.
- We are accountable for our actions.
- We make a difference EVERY DAY.

How We Do It:

- We provide a positive learning experience for all of our workers.
- We balance our home and business life.
- We continually strive to improve our quality focusing on Lean Continuous improvement.
- We are passionately involved in making the customer happy.



\$50m in Revenue \$4m Net Income 3.000 Inmate Jobs

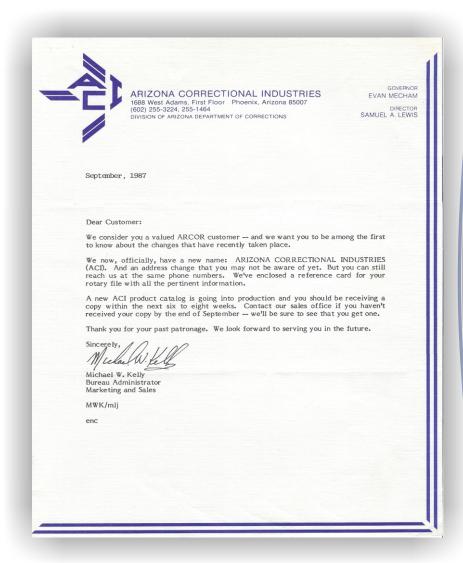


Historical Highlights

The State Legislature established Arizona Correctional Enterprises (ARCOR) in 1981 for the purpose of employing inmates.

After its first five years of operation, a comprehensive review of all aspects of the business was completed; the results initiated a complete overhaul and restructuring of the business and operating guidelines. Subsequently, in 1987 the State Legislature replaced ARCOR with Arizona Correctional Industries (ACI) under the authority of the Director of the Department of Corrections.

This new enterprise, although part of a State Agency, was expected to run like a private business with revolving cash funds generated through the sales of goods and services.



In order to reach this goal, the Legislature provided \$2.1 million for Arizona Correctional Industries with the stipulation that it become self-supporting by July 1,1989. This date was eventually extended to July 1,1991.

1988 \
Douglas Sewing Opened

Hog Farm, Slaughter House and Dairy Closed 1990



ACI moves to 1918 W. Van Buren

1991 ACI becomes Self-Sufficient 1995

Started Private Sector Partnership with Hickman's Egg Ranch and Televerde







Arts & Trade Outlet Opens in Florence

1996

Started Private Sector Partnership with Greater Auto Auction and ADOT MVD call center





1997 Inmates Employed 1,197

1998
Started Private
Sector Partnership
with Eurofresh



2000

1994

\$500,000 Net Profit 940 Inmates Employed

Started Private Sector Partnership with Dixon Farms



Garment Factory moves to Perryville from Tucson



Change-out from Men to Women at Print shop

2001 ACI moves to 3701 W. Cambridge



Started Private Sector Partnership with Eagle Milling

2002

Started Private Sector Partnership with Safety Services

Commodity Products Industry Opens in Florence



2003

Started Private Sector Partnership with Common Market Equipment

1993

AZ Office of Tourism uses Inmates on phones

1992

Inmate Workforce Increases to 765 from 497

Started Private Sector Partnership with Fiesta Canning



ACI Holds First Annual Meeting



Started Private Sector Partnership with American Curb & Vent

> **Started Private Sector Partnership** with AZ Cotton Research Protection Council

Started Private Sector Partnership with H & H Trailer

ACI Began manufacturing new **Digital License Plates**



Started Private Sector Partnership with Arizona Structural Laminators

2005



State Quality Showcase In Excellence Award

> **Started Private Sector Partnership** with Sunfresh Farms



Started Private Sector Partnership with Morrison Management Specialists



2009

ACI Begins Partnership with Bonded Logic



2010



ACI Participates in the **Intel-AQA Mentoring Project**



ACI Runner-up for the Pioneer Institute, **Better Government Competition**



2012 Arizona Wins America's **Best License Plate Award** For Arizona Centennial Plate

ACI employed an average of 1900 inmates per month during FY 2012

ACI Today

There are many aspects of ACI and its business arenas that contribute to its success in the areas of growth, profitability, and increased inmate employment. The most important aspect remains our dedicated-staff who continually go above and beyond to improve products, processes, quality, safety, and service. Many associates were involved in winning new business for ACI, including our sales team that greatly improved their performance. In addition, significant new acquisitions were won by our regional managers in the bakery, recycling, and solar industry areas.

In FY 2012, ACI managed thirteen Owned and Operated shops including, but not limited to a bakery, metal and wood fabrication, recycling, printing, signs, and license plates, and twenty one private sector partnerships that provide labor for telemarketing and agricultural services. We continually seek new opportunities to expand our Owned and Operated businesses as well as our private sector partnerships, so that we can profitably grow our business with special focus on significantly increasing overall inmate employment. ACI staff continually evaluates new business opportunities created by voids in free market labor, or as an alternative to outsourcing labor to foreign countries.

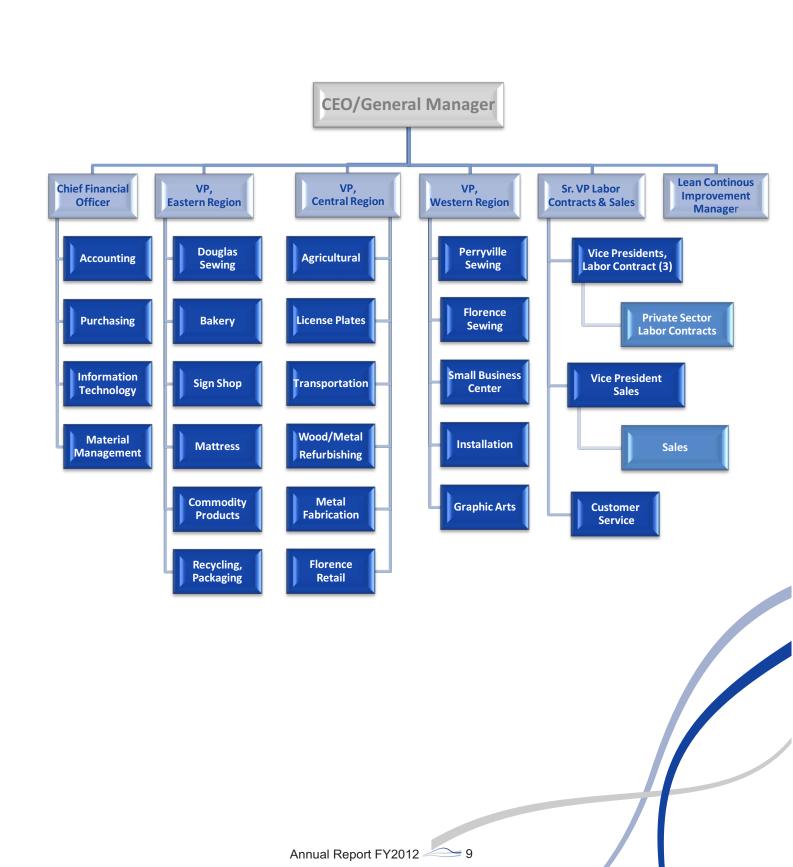
FY 2011, inmates worked 3,508,000 hours in ACI operations, and in FY 2012 we saw an increase in inmate work hours to 3,812,848. The chart below shows the total inmate hours worked over the past 10 years. Total inmate workforce numbers increased as well from a FY2011 total of 1,792 to a new high of 1,904.



Future Programs

ACI continues to explore new endeavors to employ more inmates and grow our business. Projects currently under development include a Wild Horse Program in conjunction with the Federal Bureau of Land Management that would require a training facility and corrals in the Florence area. In addition, we are seriously considering a Fish Aquaculture program where ACI would breed, raise, and process Tilapia and Striped Bass. Much activity currently exists within ACI concerning both of these endeavors and we hope to have final decisions on these projects in the near future. New labor contract business also remains a focus within ACI and we are currently working on finalizing contracts that will help grow our telemarketing and service business.

ACI Organization Chart



Executive Team

Brian Radecki

CEO/General Manager bradecki@azcorrections.gov

Glen Davis Sr. VP Labor Contracts & Marketing/Sales gdavis2@azcorrections.gov



Dale Beatty, CPA Chief Financial Officer dbeatty@azcorrections.gov

Management Team

Gregg Hillebrand

VP Western Region ghillebr@azcorrections.gov

William Foster

VP Central Region bfoster@azcorrections.gov

Alan Wesley

VP Eastern Region awesley@azcorrections.gov

Vicki Fitzpatrick

Procurement Manager vfitzpat@azcorrections.gov

Rick Brodeur

Controller rbrodeur1@azcorrections.gov

Thomas Brown

Customer Service Manager tbrown@azcorrections.gov

Richard Selepack

VP Labor Contracts rselapac@azcorrections.gov

Eric Cole VP Labor Contracts ecole@azcorrections.gov

Mario Diaz

Regional Manager mdiaz1@azcorrections.gov

Rick Kahn

VP Sales rkahn@azcorrections.gov

Anil Shukla

Materials Manager ashukla@azcorrections.gov

Malinda Strom

ESA/HR Liaison, Administration mstrom@azcorrections.gov

Benefit To The State

Arizona Correctional Industries supports the Mission and Vision of the Arizona Department of Corrections by creating work opportunities for inmates that have proven to reduce the State of Arizona recidivism rate. ACI programs differ from other work programs managed by the Department of Corrections as ACI positions tend to mirror more closely product manufacturing or service activities in the private sector and in some cases provide more marketable skills for eventual private sector employment. ACI achieves these goals by developing partnerships with the Department of Corrections, State Agencies, Municipalities, and School Districts, Private Sector business and other partners and alliances throughout the State of Arizona. These partnerships create demand for ACI products and services that create revenue growth and inmate employment at each of the ACI owned and operated shops and enterprise programs.

The utilization of inmate time and labor has a direct and positive impact on the State of Arizona budget. The employment of state workers through ACI's program, as well as the employment of inmates, contributes to our communities. Inmate wage deductions go to the State General Fund, victim and court restitution, and family support. As the State of Arizona faces budget challenges and high unemployment rates, ACI provides a steady source of funding and new job opportunities for Arizona businesses. These contributions come from two areas: raw materials and services that ACI purchases from Arizona businesses and consumer expenditures generated as a result of ACI related employment.

The Arizona State University, WP Carey School of Business; Seidman Research Institute, 2012 fiscal year study reports that Arizona Correctional Industries (ACI) contributed \$187,430,000 to Arizona's economy. More notable was the creation of an estimated 2,080 jobs within the State of Arizona economy.

ACI contributed to Arizona's centennial this year when the Automobile License Plate Collectors Association, the world's oldest and largest nonprofit organization devoted to researching, collecting, and promoting license plates bestowed an award of which all Arizona can be proud.

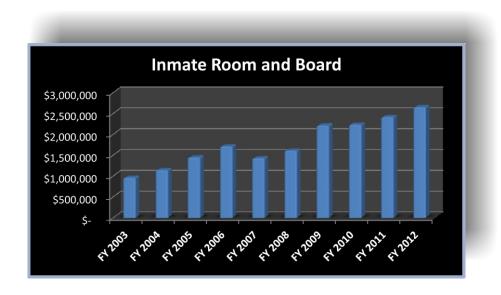


"Arizona Wins America's Best License Plate Award." This national contest has honored the top plate each year since 1970. The Automobile License Plate Collection Association has overwhelmingly voted that Arizona has the best plate in the United States.

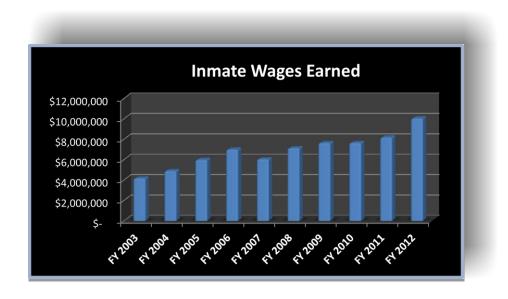
Bill Beckett MVD Distribution Manager states "ACI deserves as much credit as anyone else on this plate design award. You guys work hard for us and always strive to ensure we get the best possible plates. Congratulations to you and your team as well."

Inmate Contributions

Deductions from inmate wages reduce the cost of room and board and contribute to the General Fund. Total inmate contributions for FY 2012 totaled \$2,653,000. The chart below highlights a 9.8% increase in inmate contributions towards room and board in FY 2012.

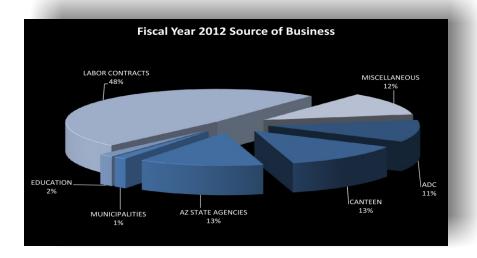


ACI inmate wages rose during FY 2012 to \$10,047,000, a 23% growth over the prior fiscal year.



Source of Business

ACI has two revenue sources: Labor Contracts and Owned and Operated business. Labor Contracts accounted for 47% of ACI's total revenue; moreover the Labor Contracts resulted in 59.3% of the total inmate hours worked. The second source of revenue is ACI's Owned and Operated businesses. Owned and Operated contributed 53% of total revenue, and hours worked for the Owned and Operated Business were 40.7% of the total inmate hours worked.



ACI tracks sales by type of customer. Below is a chart showing our top ten customers by sales during the past year.

TOP TEN CUSTOMERS FY 2012					
EUROFRESH CANTEEN HICKMAN EGG RANCH ARIZONA DEPARTMENT OF CORRECTIONS ARIZONA DEPARTMENT OF TRANSPORTATION COMMON MARKET EQUIPMENT TELEVERDE GESTAMP SOLAR STEEL SAFETY SERVICES KEEFE	\$	6,240,508 4,848,002 3,680,308 3,543,057 3,288,195 2,948,940 2,704,536 1,103,765 931,728 636,057			
TOTAL SALES OF TOP TEN CUSTOMERS	\$	29,925,096			
TOTAL SALES	\$	38,450,425			
PERCENTAGE		77.83%			

New Products

With the unique capability of customizing a city's colors, logos, or architectural details, ACI has been building custom bus shelters for cities throughout Arizona. During FY 2012, ACI produced new shelters for Benson, Sedona, and Lake Havasu.

In addition, ACI recently completed a heavy-duty custom pallet project for Gestamp Solar Industries.



City of Benson



City of Sedona



Lake Havasu City



Gestamp Solar Pallet

Economic Innovation

Smaller budgets were the norm in State Government during FY 2012. Staying responsive to customer needs spurred a spirit of innovation throughout ACI. For example, ACI supplied bus stop bench components to the Arizona Department of Transportation's Motor Vehicle Division re-purposing the usage of an ACI product at a lower cost. It is this spirit of innovation that helped ACI grow in this challenging economy.



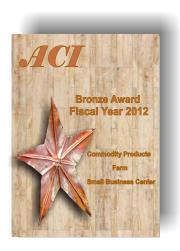
Fiscal Year 2012 **ACI Recognition Awards**











Financial Performance

FY 2012 Sales and Gross Profit

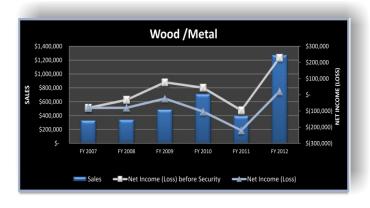


FY 2012 Owned and Operated



Owned and Operated Success

The Owned and Operated business of Arizona Correctional Industries consist of thirteen different business operations located throughout the state. ACI is responsible for all aspects of these operations including marketing, sales, design, manufacturing, and delivery. Four shops stood out as success stories during the past fiscal year with each making a contribution towards ACI's growth.

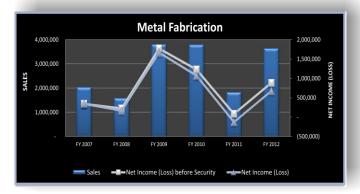


Wood/Metal increased sales by 222%

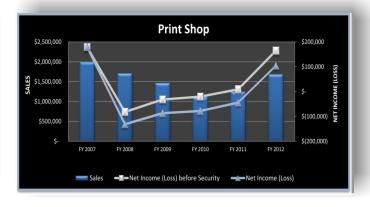
- Northern Arizona University
- Arizona Board of Respiratory Examiners
- Maricopa Community Colleges

Metal Fabrication increased sales by 100%

- Swift Trucking
- Gestamp and Rio Glass







Sign Shop increased sales by 9%

- University of Arizona
- Shop profitability rose for the first time in years thanks to management's continuous improvement efforts.

Print Shop increased sales by 35%

High order volume - DES and other state agencies

Labor Contract Success

The ACI Labor Contract Division (LCD) manages twenty one Private Sector Contracts, one Prison Industry Enhancement Certification Program (PIECP) that permits interstate commerce, and one Inter-Government Agreement (IGA). The IGA program is with the Arizona Motor Vehicle Department (MVD) where ACI inmates staff "level one" call centers for MVD to assist with requests for general information. Other partnerships include semi-truck and trailer refurbishing, agricultural, business-to-business call centers, trailer manufacturing, modular building construction, auto detailing, and food processing.





ACI and our Labor Contract partners expanded inmate work at Eurofresh, Hickmans, Safety Services, and MVD. In addition, we added JimGlo Trailer Production in Kingman.

DEPARTMENT OF CORRECTIONS ARIZONA CORRECTIONAL INDUSTRIES

FINANCIAL STATEMENTS (unaudited)

Year Ending June 30, 2012

STATEMENT OF NET ASSETS - ENTERPRISE FUND						
	2011	2012				
Assets						
Current Assets	\$ 10,957,011	\$ 13,285,075				
Noncurrent Assets	3,207,710	3,092,517				
Total Assets	14,164,721	16,377,592				
Liabilities Current Liabilities Long Term Liabilities	1,508,894 19,866	1,965,080				
Invested in Capital Assets (Net of Related Debt) Unrestricted Total Net Assets	3,077,822 9,558,127 \$ 12,635,949	3,072,651 11,339,847 \$ 14,412,498				

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS					
	2011	2012			
Salaa	¢ 24 407 470	¢ 20.450.405			
Sales	\$ 34,137,476	\$ 38,450,425			
Cost of Goods Sold	27,443,813	31,148,161			
Gross Profit	6,693,663	7,302,264			
Operating Expenses					
Selling	852,658	1,055,118			
General and Administrative	2,981,598	3,072,507			
Total Operating Expenses	3,834,256	4,127,625			
Operating Income	2,859,407	3,174,639			
Nonoperating Revenue (Expenses) Investment Income Net Gain (Loss) on Disposal of Equipment Interest Expense Net Nonoperating Revenues (Expenses)	8,744 (3,199) (24,376) (18,831)	20,002 (519) (9,973) 9,510			
Net Income	2,840,576	3,184,149			
Transfers out to other state funds	(328,300)	(1,407,600)			
Increase (decrease) in net assets	2,512,276	1,776,549			
Total net assets, July 1	10,123,673	12,635,949			
Total net assets, June 30	\$ 12,635,949	\$ 14,412,498			

STATEMENT OF CASH FLOWS - ENTERPRISE FUND						
		2011			2012	
Net cash used for operating activities Net cash provided (used) for noncapital financing activities	\$	2,389,483 (328,300)		\$	3,496,716 (1,407,600)	
Net cash provided (used) for capital and related financing activities Net cash provided (used) by investing activities		(480,563) 8,744	_		(433,214) 20,002	
Net increase (decrease) in cash and cash equivalents		1,589,364			1,675,904	
Cash and cash equivalents, July 1		1,774,596	_		3,363,960	
Cash and cash equivalents, June 30	\$	3,363,960		\$	5,039,864	

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) FOR OPERATING ACTIVITIES						
		2011		2012		
Operating income Adjustment to reconcile operating income to net of provided (used) for operating activities	\$ ash	2,859,407	\$	3,174,639		
Depreciation		522,850		518,050		
Net changes in assets and liabilities		(992,774)		(195,973)		
Net cash provided (used) for operating activities	\$	2,389,483	\$	3,496,716		

SCHEDULE OF FIXED ASSET AND ACCUMULATED DEPRECIATION						
	2011	INCREASE	DECREASE	2012		
SCHEDULE OF FIXED ASSETS						
Land	692,438			692,438		
Land Improvements	240,438			240,438		
Building	788,649		5,841	782,808		
Building Improvements	1,141,635			1,141,635		
Equipment	7,471,266	406,902	392,152	7,486,016		
Totals	\$ 10,334,426	\$ 406,902	\$ 397,993	\$ 10,343,335		
SCHEDULE OF ACCUMULATED D	EPRECIATION					
Land Improvements	239,685			239,685		
Building	443,984	29,511	5,852	467,643		
Building Improvements	533,845	52,774		586,619		
Equipment	5,909,202	435,765	388,096	5,956,871		
Totals	\$ 7,275,377	\$ -	\$ -	\$ -		
Property, Plant, Equipment, Net	\$ 3,059,049	\$ 406,902	\$ 397,993	\$ 10,343,335		

SCHEDULE OF CAPITAL LEASE AND ACCUMULATED DEPRECIATION						
	2011	INCREASE	DECREASE	2012		
SCHEDULE OF LEASED ASSETS						
Land						
Land Improvements						
Building						
Building Improvements						
Equipment	439,985			439,985		
Construction in progress						
Totals	\$ 439,985	\$ -	\$ -	\$ 439,985		
SCHEDULE OF ACCUMULATED D	DEPRECIATION					
Land Improvements						
Building						
Building Improvements						
Equipment	206,244	54,998		261,242		
Totals	\$ 206,244	\$ 54,998	\$ -	\$ 261,242		
Leased Assets, Net	\$ 233,741	\$ (54,998)	\$ -	\$ 178,743		



Arizona Correctional Industries recognizes the leadership of the past twenty-five years for helping to guide and shape the prison industries program in Arizona.

Marilyn Wilkens 1987
John Spearman 1992
Charles Flanagan 2004
Lynn McAuley 2007
William Branson 2008
Brian Radecki 2011





